IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 11..07..2005

CORAM

THE HON'BLE MR.MARKANDEY KATJU, CHIEF JUSTICE
and
THE HON'BLE MR.JUSTICE F.M.IBRAHIM KALIFULLA

T.C.(A) No.394 of 2001

Narayanan Chettiar Industries,
14, Davidson Street,
Chennai - 1. ..Appellant/Appellant.

Vs.

The Income-tax Officer,
City Ward - V(3),
Chennai. ..Respondent/Respondent.

Appeal against the order of the Income-tax Appellate Tribunal "C" Bench, Chennai dated 14.05.2001 in ITA No.761 of 2000 against (the order of the Commmissioner of Income Tax(Appeals) Chennai dt.19.3.98 and made in G.I.No.PA.No.326 N the Assessment order dt.26.3.97 of the Income Tax officer, city Ward V(3), Chennai for the Assessment year 1992-93).

For Appellant :: Mr.P.P.S.Janardhana Raja

For Respondent :: Mrs.Pushya Sitaraman,
Sr.Standing Counsel for I.T.

J U D G M E N T

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THE HON'BLE THE CHIEF JUSTICE

This is an appeal under Section 260A of the Income-tax Act which was admitted on the following substantial question of law:-

> "Whether the Tribunal was right in treating the amount of Rs.23,66,695/- (the amount which was written off by the sister concern of the assessee) as the income in the hands of the assessee and on that count liable to be taxed under Section 41(1) of the Income-tax Act?"

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2. We have heard the learned counsel for the parties and perused the records, including orders of the Income-tax authorities. All the authorities have decided on the above point against the assessee.

3. The question is as to whether the amount in question can be added as income in the hands of the assessee under Section 41 (1) of the Income-tax Act.

4. It is well settled that the revenue can add a sum to the assessee's income under Section 41(1) of the Income-tax Act only if it can prove that the allowance or deduction has been made in the assessment in the previous year in respect of the loss, expenditure or trading liability.

5. As observed by the Supreme Court in Tirunelveli Motor Bus Service Co. (P) Ltd. Vs. CIT, (1970) 78 ITR 55, unless it is established that a deduction of liability was allowed while making the assessment in the earlier year, the addition as deemed profits under Section 41(1) in respect thereof would not be permissible.

6. The same view was taken in CIT Vs. Thakurdas, (1984) 147 ITR 549, CIT Vs. Kharaiti Lal & Co. (1989) 175 ITR 265, CIT Vs. Lal Textile Finishing Mills (P) Ltd. (1989) 180 ITR 45, CIT Vs. Pranlal P.Doshi, (1993) 201 ITR 756, CIT Vs. Western Rolling Mills, (1994) 72 Taxman 155, etc.

7. The learned counsel for the appellant/assessee has submitted that in this case there is no deduction or allowance made in the assessment of any year and there is no finding to this effect.

8. On the other hand, the learned counsel for the department has contended that the assessee had not raised this issue before the Income-tax Tribunal, as can be seen from the grounds of appeal before the Tribunal.

9. We have perused the grounds of appeal filed before the Tribunal. We find that there is no such ground which was raised before the Tribunal which is being sought to be raised before us now. However, there is a general ground being ground No.1 which was raised before the Tribunal:-

> "The Commissioner of Income-tax (A) erred, both in law and on the facts of the case, in determining the profit u/s.41(1) of the Act".

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10. In the order of the Assessing Officer it has been stated (in page – 3):-

> "…….
>
> ii) No deduction had been allowed in respect of the above amounts received from M/s.India Leather Corporation (P) Ltd., and the assessee did not derive any benefit in respect of the above liability".

11. In the order of the CIT (Appeals) also it has been stated at page –2:-

> "It was also pleaded that no deduction had been allowed in respect of the above amount and the appellant firm did not derive any benefit in respect of the above liability".

12. No doubt, before the Tribunal this ground which is sought to be taken now before us was not taken in clear cut terms (though it is included in the general ground No.1 before the Tribunal). However, in our opinion, this ground goes to the root of the matter since unless an allowance or deduction has been made in the computation of profit or gains of the business or profession in respect of loss, expenditure or trading liability incurred by the assessee no addition can be made under Section 41(1), vide Juggilal Kamlapat Vs. CIT, (1975) 101 ITR 40, Sharma & Co. Vs. ITO, (1972) 86 ITR 741, Indian Motor Transport Co. Vs. CIT, (1978) 114 ITR 677, etc.

13. Section 41(1) of the Income-tax Act creates a legal fiction, and hence has to be strictly complied with if any addition in the income is sought to be made by the revenue.

14. Thus, the question sought to be raised before us goes to the root of the matter because unless an allowance or deduction has been made in the previous year in respect of loss, expenditure or trading liability there can be no addition under Section 41(1) of the Income-tax Act.

15. A perusal of the impugned order of the Income-tax Appellate Tribunal shows that there was no finding of the Tribunal that any deduction or allowance was made in the assessment of the assessee in an earlier year. In the circumstances, we set aside the impugned order of the Tribunal and remand the matter to the Tribunal for a fresh decision in accordance with law after hearing the parties concerned in which a clear finding should be given whether any deduction has been allowed in the assessment of the assessee in an earlier year so

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as to comply with Section 41(1) of the Income-tax Act. This appeal is allowed, the impugned order of the Tribunal is set aside, and the matter is remanded to the Tribunal for a fresh decision in accordance with law.

sm

Sd/
Asst.Registrar

/true copy/

Sub Asst.Registrar

To

1. The Asst. Registrar, Income Tax Appellate Tribunal,
   III Floor, Rajaji Bhavan, Besant Nagar,
   Chennai-600 090.

2. The Commissioner of Income Tax(Appeals),
   121, Mahatma Gandhi Raod, Chennai-34.

3. The Income Tax Officer, City Ward V(3),
   Chennai.

+1 CC to Ms.Pushya Sitaraman, Advocate,
SR.Sc.for IT, Chennai SR. No.28529.

RRN(C.O)
BG/22.07.2005.

T.C.(A) No.394 of 2001

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